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Is My 401(k) Okay?

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If you are currently employed, your employer may offer a retirement plan in the form of a 401(k). A lot of confusion exists about what it is and how it works. A 401(k) is a type of retirement savings account and is considered a qualified plan in the eyes of the IRS.

This type of retirement plan is also referred to as a defined contribution plan. What does that mean? Well, the part that is known, or defined, is the contributions going into your plan. This is made up of money you set aside from your paycheck and any portion that your employer may contribute on your behalf. What isn't defined is how much you will receive at retirement. So the decisions and actions you take today, can have a significant effect on your lifestyle in the future.

In the past, the more common type of retirement plan was called a defined-benefit plan. We often think of these as the classic pension plan. After a certain number years of service, you would be entitled to receive an exact amount paid monthly, usually for the remainder of your life. Sadly, the expense of those plans got very high. The 401(k) was seen as a better alternative and further giving people more choices and latitude with their investment.

The key to your success can be maximizing the total amount of money saved in your 401K. How do I do this? The following simple steps can help.

Maximize Your Contribution. Please.
The thing to realize about the 401(k) is that the government wants you to save for retirement, and offers three nifty incentives:

1. Tax deferral on all contributions
2. Tax deferral on any gains on your investments
3. And, if your employer is generous, they may contribute to your plan and the government will defer any taxes on these contributions until retirement.

What does this mean? It is generally in your best financial interest to put in the maximum amount into your 401K. "But I feel stressed and not sure I can afford it." I'm not so sure you can afford not to do it. Imagine later in life with little or no retirement savings. To me, that is a far more stressful thought. Also, get real with what contributing means. Let's assume you elect put $100 in your 401(k) each pay period. Depending on your tax bracket, the truth is that your net paycheck may only be reduced by $80 (possibly even less). Let's say your employer offers a 100% match. That means $200 will go into your 401k each pay period. What is the reality? You are taking home $80 less in exchange for $200 toward your retirement. Seems like a fair deal to me. Try to contribute to the point at which your employer will match. Better yet, contribute the absolute maximum allowed under the law.

Make The Right Investment Decisions.
Is your retirement money properly invested? Generally speaking, there will be an investment adviser or broker who works with the retirement plan. They are responsible (in most cases) to offer education about your plan and investment options.

"Where is this person? I've never seen him or her."

Reach out to your human resources department and find out who is responsible for the 401k in your company. They will have the contact information for this person. Also, request an "enrollment booklet" for the plan. This typically offers some helpful advice and will list your investment options.

If you don't necessarily have the time or the knowledge as to how to manage investments, there may be an easy solution. Many 401(k)s will include the option for "lifecycle" or "target retirement" funds. This fund should be matched to your expected retirement date. Let's say your retirement is 20 years in the future. You would select the fund that is dated on around 2030.

This fund usually contains a diversified mix of stocks, bonds, cash, etc. As you grow older, the fund automatically rebalances itself in an attempt to take less risk. The percentage of bonds versus stocks steadily increases over time. The closer you are to retirement, the more bonds you should have in your portfolio. The target retirement fund automatically does the work for you. So, if you are a little unsure on how to navigate the investment world, consider the target retirement fund.

Watch Out For Those Fees.
A little known item looked at by very few people are the expenses you pay in your 401(k). These are automatically deducted from your account, and often times it's nearly impossible to ascertain how much you are being charged. "Does an extra 1% matter?" Absolutely! Paying an extra 1% over 20 years can result in you retiring with 20% less money.

After you review and determine your investment options, do a little research and find out some of the fees being charged. Morningstar.com is a wonderful resource. Enter the ticker symbol for your investment, and look at the "expenses". Anything above of 1.5%, in my opinion, is excessive. You may want to speak to the retirement plan administrator at your company about including low cost options in the 401(k). Also, be on the lookout this year for "fee disclosure". This will tell you exactly how much you are being charged in total fees in your 401k. If it seems high or excessive, consider asking your employer if they have investigated other options.

Knowledge is power. Hopefully after reading this you have a little more knowledge about your retirement plan. Now it is up to you to act. Keep it simple and focus on the three bullet points above. This can dramatically alter your retirement years for the better. Please don't forget to allow yourself to feel good about making positive changes in your life.